APPENDIX.

Revenue Act of 1936, c. 690, 49 Stat. 1648:

Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(a) Expenses.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensations for personal services actually rendered; * * *.

* * * *

Sec. 117. Capital Gains and Losses.

* * * *

(b) Definition of Capital Assets.—For the purposes of this title, "capital assets" means property held by the taxpayer (whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * *

(d) Limitation on Capital Losses.—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

Art. 23 (a)-1. Business expenses.—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, * * *. Among the items included in business expenses are management expenses, commissions, * * *. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses ex-

ceed the gross income derived during the taxable year from such business. * * *

* * * * *

Art. 24-2. Capital expenditures.—Amounts paid for increasing the capital value or for making good the depreciation (for which a deduction has been made) of property are not deductible from gross income. (See section 23(1).) Amounts expended for securing a copyright and plates, which remain the property of the person making the payments, are investments of capital. The cost of defending or perfecting title to property constitutes a part of the cost of the property and is not a deductible expense. The amount expended for architects' services is part of the cost of the building. Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities, when such commissions are not an ordinary and necessary business expense, are an offset against the selling price. Expenses of the administration of an estate, such as court costs, attorneys' fees, and executors' commissions, are chargeable against the corpus of the estate and are not allowable deductions. Amounts to be assessed and paid under an agreement between bondholders or shareholders of a corporation, to be used in a reorganization of the corporation, are investments of capital and not deductible for any purpose in returns of income. (See article 22 (a)-17.) An assessment paid by a shareholder of a national bank on account of his statutory liability is ordinarily not deductible but, subject to the provisions of the Act, may in certain cases represent a loss. Expenses of the organization of a corporation, such as incorporation fees, attorneys' and accountants' charges, are capital expenditures and not deductible from gross income. A holding company which guarantees dividends at a specified rate on the stock of a subsidiary corporation for the purpose of securing new capital for the subsidiary and increasing the value of its stock holdings in the subsidiary may not deduct amounts paid in carrying out this guaranty in computing its net income, but such payments may be added to the cost of its stock in the subsidiary.

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In the Supreme Court of the United States

OCTOBER TERM, 1941

NOS. 693–694

GEORGE W. COVINGTON AND KATE ELLIS COVINGTON, PETITIONERS

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

MEMORANDUM FOR THE RESPONDENT

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 18–26) is reported in 42 B. T. A. 601. The opinion of the Circuit Court of Appeals for the Fifth Circuit (R. 50–57) is reported in 120 F. (2d) 768.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 9, 1941 (R. 57), and a petition for rehearing was denied July 11, 1941 (R. 63).

The petition for writs of certiorari was filed October 10, 1941. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Whether the losses resulting from dealing in commodities futures contracts were properly classified as capital losses, subject to the limitations of Section 117 (d) of the Revenue Act of 1936.

2. Whether any part of the commissions paid to brokers for placing and closing commodities futures contracts are deductible as ordinary and necessary business expenses.

STATUTES AND REGULATIONS INVOLVED

Revenue Act of 1936, 49 Stat. 1648:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> (a) *Expenses.*—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; * * *
>
> * * * * *
>
> SEC. 117. CAPITAL GAINS AND LOSSES.
>
> * * * * *
>
> (b) *Definition of Capital Assets.*—For the purposes of this title, "capital assets" means property held by the taxpayer

(whether or not connected with his trade or business), but does not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

* * * * *

(d) *Limitation on Capital Losses.*—Losses from sales or exchanges of capital assets shall be allowed only to the extent of $2,000 plus the gains from such sales or exchanges. * * *

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (a)–1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under the provisions of articles 23 (b)–1 to 23 (q)–1. Double deductions are not permitted. Amounts deducted under one provision of the Act can not again be deducted under any other provision of the Act. The cost of goods purchased for resale with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. (See article 22 (a)–5.) Among the items included in business expenses are management expenses,

commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, * * *

* * * * *

ART. 24–2. *Capital expenditures.*— * * * Commissions paid in purchasing securities are a part of the cost price of such securities. Commissions paid in selling securities, when such commissions are not an ordinary and necessary business expense, are an offset against the selling price. * * *

STATEMENT

This case involves the income tax liability of George W. Covington[1] for the years 1936 and 1937. The facts, as found by the Board of Tax Appeals (R. 19–21), may be stated as follows:

The taxpayer has been engaged for some 20 years in trading individually in commodities futures pertaining to cotton and related products. He devoted a substantial part of his time to such trading, and was a member of the New York Produce Exchange, the Memphis Cottonseed Exchange, Merchants Exchange, and the National Cottonseed Products Association. He kept abreast of the current movements of the commodities through the trade journals to which he subscribed and through statistical information compiled with the assistance of a research man employed for that purpose (R. 20).

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[1] His wife was named in the litigation because a joint return was filed (R. 7).

In the taxable years, brokers' commissions paid by the taxpayer and his losses on trading in futures contracts were as follows (R. 20):

	1936	1937
Commissions	$2,880.00	$39,619.00
Trading losses	25,120.00	58,716.00

All of the transactions involving futures contracts were executed on exchanges whose rules are substantially in accord.[2] The taxpayer did not take delivery of any commodities on futures contracts during the taxable years 1936 and 1937 (R. 21).

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[2] The rules of the New York Produce Exchange provide that all offers to buy and sell shall be presumed to have been made in the following form (R. 20–21):

"_____ of the County of _____ State of _____ have this day-{bought from / Sold to} _____ and agreed to{receive from / deliver to}_____ of the County of _____ State of _____ 60,000 pounds of loose Bleachable Prime Summer Cotton Seed Oil, at a price of _____ cents and _____ hundredths cents per pound, in licensed bonded warehouse basis f. o. b. New York; deliverable between the first and last days of _____ inclusive; at seller's option. The oil dealt with herein shall be Prime Summer Yellow Cotton Seed Oil; shall be of American origin, and produced within the United States of America, and must be clear, free from water and settlings, sweet in flavor and odor, and when bleached as per Rule 101 of the Rules Governing the Chemistry Bureau, the color of the oil to be passed upon shall not be darker than the combined standard glasses .20 yellow, 2.5 red of Lovibond's color scale, and shall not contain more than one-quarter of one percent free fatty acids.

"This agreement is made subject to all the By-laws, Rules and customs of the New York Produce Exchange."

Commissions to brokers in handling the purchases and sales on the various exchanges were paid when each purchase and sale, each trade or contract, was consummated. The commissions were neither buying nor selling commissions as such, but were charges by brokers for placing and closing the futures contracts on the various exchanges (R. 21).

The Board concluded that (R. 24–25) the losses were capital losses subject to the statutory limitation, but that (R. 26) one-half of the commissions was deductible as business expenses attributable to the sales.

The Government appealed (R. 27–32) with reference to the deductibility of sales commissions as expenses, and the taxpayer appealed (R. 37–42) with reference to the disallowance of purchase commissions and with reference to the ruling that the losses were capital losses. The court below sustained the Government on all issues.

ARGUMENT

1. The first ground of the petition presents no basis for the issuance of the writ. No contention is made that there is any conflict on this issue (Pet. 6). The court below correctly decided that (R. 53) the petitioner was engaged in buying and selling commodities or rights in commodities and that the losses incurred therein were capital losses subject to the limitation of Section 117 (d), *supra*.

2. There is, however, a conflict of decisions as to whether broker's commissions upon sales of securities are deductible as expenses (rather than being employed to reduce the amount of the sales price), that question is raised in *Spreckels* v. *Helvering,* Nos. 581–582, this Term, certiorari granted October 20, 1941. The commissions involved herein are not strictly sales commissions; the taxpayer paid a single commission upon the initiation and the closing of a futures transaction, and the Board of Tax Appeals treated one-half thereof as comparable to a sales commission. The court below likewise treated one half of the commissions as sales commissions and was of the opinion that its decision was contrary to those of the Second Circuit in *Winmill* v. *Commissioner,* 93 F. (2d) 494, and *Neuberger* v. *Commissioner,* 104 F. (2d) 649. In these circumstances, it would be appropriate for the Court either to grant the petition on this point, or to withhold action thereon until the disposition of the *Spreckels* case.

CONCLUSION

The decision of the court below is correct. There is no conflict except with respect to the commissions issue. If granted, the writ should be limited to that issue.

Respectfully submitted,

WARNER W. GARDNER,
Acting Solicitor General.

OCTOBER 1941.

U. S. GOVERNMENT PRINTING OFFICE: 1941